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EX PARTE OR LATE FILED

July 28, 1999

Ms. Magalie Roman Salas  
Secretary, Federal Communications Commission  
The Portals, 445 12th Street, S.W.  
Washington D.C. 20554

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JUL 28 1999


FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

Re: **Ex Parte Notification**  
**Direct Access to the INTELSAT System**  
**IB Docket No. 98-122 / File No. 60-SAT-ISP-92**

Dear Ms. Salas:

On July 27, 1999, Robert S. Koppel, Bradley Stillman and Alfred M. Mamlet on behalf of MCI WorldCom, Inc. spoke with Ari Fitzgerald in the Office of Chairman Bill Kennard about the above-referenced matter. Specifically, MCI WorldCom reiterated its support for FCC implementation of direct access to INTELSAT, provided a briefing on the status of legislative activity regarding direct access, and urged the FCC to require space segment portability so that the full benefit of direct access could be realized. We referred to an analysis prepared by Solomon Smith Barney (relevant pages attached) that demonstrates the need for space segment portability to realize the full competitive benefits of direct access.

Sincerely,

  
Alfred M. Mamlet

cc: Ari Fitzgerald

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# SALOMON SMITH BARNEY

EQUITY RESEARCH: Satellite Services

October 5, 1998

John B. Coates, CFA (212) 816-2755

Company Report

john.coates@smb.com

**Value**

Value

## COMSAT Corporation

NYSE: CQ

Rating: 2H (Outperform, High Risk)

### Release the Hounds; Initiating Coverage

#### Opinion:

- **Vigilantes of Value:** COMSAT (CQ) is in the middle stages of a transformation from an inefficient organization to a focused provider of satellite services and private network solutions. Under new management, COMSAT has divested non-core assets and worked toward the deregulation of the company's core operations.
- **Asset Play:** Privatization and IPOs of affiliates are likely windows of value and catalysts to move the stock. Three of the company's four large investments appear set to issue stock to the public in the next two years. Another value driver is COMSAT's networking business, which should generate revenue growth of 25% over the next few years.
- **Takeover Target:** Lockheed Martin bid \$45.50 per share for half of CQ. The stock has remained flat on the risk that the deal may not go through. Our analysis yields a year-end 1999 price target of \$42, which is 19% above current levels. We initiate coverage with a 2H (Outperform, High Risk) rating.

| Price<br>9/30/98 | 52-Week<br>Range | Earnings per Share |        |        | P/E Ratios |        | Yield | Est. 5-Yr.<br>EPS Growth |
|------------------|------------------|--------------------|--------|--------|------------|--------|-------|--------------------------|
|                  |                  | 12/97A             | 12/98E | 12/99E | 12/98E     | 12/99E |       |                          |
| \$35             | \$42-\$21        | \$0.57             | \$0.35 | \$0.54 | 101x       | 65x    | 0.5%  | 30%                      |

Market Capitalization: \$1.8 bil.

S&P 500: 1017

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**COMSAT WORLD SERVICES (CWS)** CWS provides voice, data, and video communications between the United States and other countries using the Intelsat system. COMSAT controls about 18% of Intelsat, and consolidates its portion of Intelsat's results in its financial statements. The segment accounts for \$263 million, or almost half, of the company's overall revenues. Most of CWS's revenues come from leasing full-time voice and data circuits to international carriers for long-distance service. In 1997, revenues from AT&T and MCI represent almost half of CWS's revenues, or 22% overall.

CWS's revenue growth has lagged that of the industry mainly because Intelsat's bread-and-butter market, carrying international voice traffic services, has lost share to land-based fiber capacity. In the past decade, Intelsat's share of the international voice market has fallen steadily, from 70% to about 20%, as fiber has become increasingly available. In contrast, privately owned satellite operators have focused on providing faster-growing video distribution and business network services. Going forward, COMSAT expects this segment to grow at a moderate single-digit rate.

**COMSAT MOBILE COMMUNICATIONS (CMC)** CMC provides mobile voice and data applications for land, sea, and air subscribers using Inmarsat's nine-satellite system. COMSAT controls about 22% of Inmarsat, and includes its share of Inmarsat's operating results in its financial statements. As shown in Figure 9, CMC's revenues have declined over the past two years, and now account for 30% of the company's overall revenues. We estimate the government makes up 25% of this segment's revenues.

In our opinion, the growth outlook for CMC is moderate. The advent of the Big-LEOs, such as Globalstar, ICO Global, and Iridium, will likely place substantial competitive pressure in CMC's voice market. Plus, we believe that CMC could have trouble competing against the Big-LEOs, which should offer competitive services over smaller equipment with less voice delay. The upside is that Inmarsat stands to grow in the mobile data business and retain revenues as a service provider of ICO's mobile satellite service.

**HOW DOES COMSAT ADD VALUE?** One of the most voiced complaints about COMSAT's practice is that the company takes advantage of its monopoly status and marks up its cost on Intelsat and Inmarsat space capacity by an unfair amount without adding value. In the last five years, we estimate that COMSAT received price premiums on Intelsat and Inmarsat capacity of 69% and 116%, respectively (see Figure 11). The premium explains why the carriers would prefer to gain direct access to the wholesaler (Intelsat and Inmarsat) and cut out the middleman. COMSAT points out that critics of the price premium fail to address COMSAT's costs as a partial owner.

**DIRECT ACCESS IS A THREAT** One of the controversial provisions of the Bliley Bill is allowing direct access to Intelsat and Inmarsat, bypassing COMSAT. The threat of direct access depends on what level of access is allowed. There

|                                     | 1993  | 1994  | 1995  | 1996  | 1997  | Average Premium |
|-------------------------------------|-------|-------|-------|-------|-------|-----------------|
| <b>COMSAT World Systems</b>         |       |       |       |       |       |                 |
| Intelsat Revenues                   | 658   | 706   | 805   | 911   | 962   |                 |
| COMSAT's ownership                  | 20.2% | 19.1% | 19.1% | 19.1% | 18.0% |                 |
| COMSAT's share of revenues          | 133   | 135   | 154   | 174   | 173   |                 |
| CWS Revenues                        | 245   | 252   | 255   | 273   | 263   |                 |
| Price Premium                       | 84%   | 87%   | 66%   | 57%   | 52%   | 69%             |
| <b>COMSAT Mobile Communications</b> |       |       |       |       |       |                 |
| Inmarsat Revenues                   | 351   | 334   | 340   | 369   | 384   |                 |
| COMSAT's ownership                  | 22.5% | 24.1% | 24.0% | 23.0% | 23.0% |                 |
| COMSAT's share of revenues          | 79    | 80    | 82    | 85    | 88    |                 |
| CMC Revenues                        | 190   | 194   | 180   | 161   | 168   |                 |
| Price Premium                       | 141%  | 141%  | 121%  | 90%   | 90%   | 116%            |

Source: Company reports, Salomon Smith Barney. Assumes difference between COMSAT's space segment utilization charges and its portion of IGO revenues is negligible; where this difference is not negligible (i.e., CMC), the actual price premium may differ significantly from our estimates.

are four levels of access (see Figure 12). Levels 1 and 2 provide access to information. In contrast, Levels 3 and 4 allow customers to access space segment capacity directly. Level 3 authorizes a customer other than a signatory to directly order, receive, and pay for space segment capacity, presumably at lower rates than what COMSAT charges. Level 4 takes access one step higher, and allows a customer to invest directly in the IGO. If Level 3 or 4 direct access is allowed, we would expect to see the rate that COMSAT charges (or traffic going through COMSAT) come under pressure. For this reason, the risk relating to direct access is that COMSAT receives zero compensation for its partial ownership of the IGOs. In other words, the downside is that COMSAT's traffic and price premium disappear, and COMSAT effectively becomes a holding company for the IGOs with no incremental business. Our sum-of-the-parts analysis, which begins on page 26, reflects this assumption that no value is assigned to COMSAT's incremental business. In reality, direct access is somewhat muted by three factors. First, direct access is an issue only for the residual portion of Intelsat because Inmarsat and New Skies are set for privatization. Second, more than half of CWS's business is under long-term contracts (these contracts are themselves under scrutiny), meaning that only short-term contracts and new business opportunities are vulnerable. Finally, and most importantly, COMSAT has a capacity contract with Intelsat, which gives the company ownership of the vast majority of capacity connecting with the U.S. In effect, others can play ball under direct access, but COMSAT owns the equipment.

- Level 1: Operational and Technical Access
- Level 2: Commercial and Service Matter Access
- Level 3: Contractual Access
- Level 4: Direct Investment

Source: Intelsat